# MANAGEMENT AUDIT REPORT

## **OF THE**

# CITYWIDE FISCAL YEAR 2003 YEAR END CLOSE

04-101B



City of Albuquerque Office of Internal Audit



# City of Albuquerque P.O. BOX 1293 ALBUQUERQUE, NEW MEXICO 87103

February 20, 2004

Internal Audit Committee City of Albuquerque Albuquerque, New Mexico

Audit: Citywide

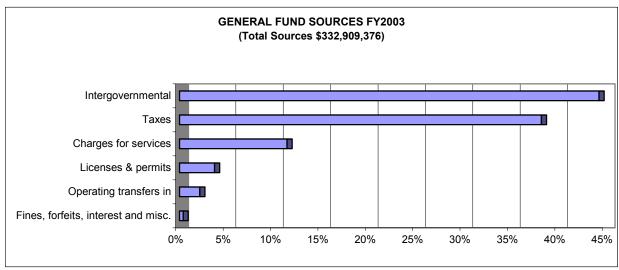
Fiscal Year 2003 Year-End Close

04-101B

#### **FINAL**

#### **INTRODUCTION**

The City of Albuquerque (the City) operating budget is prepared annually for the General, Enterprise, Special Revenue, Internal Service, Debt Service and Capital Project funds. Each year the City is required to have a balanced budget so that expenditures cannot exceed revenues and other sources. Sources of funding for the City's General Fund for fiscal year (FY) 2003 were as follows:



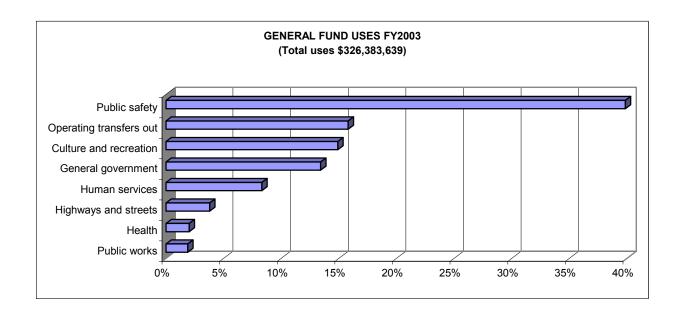
The City makes appropriations at the program level. A program is a group of activities directed to achieve specific purposes or objectives. A department can have several different programs.

Expenditures may not exceed appropriations at the program level. Budgetary control is maintained by a formal appropriation and encumbrance system. The Mayor has authority to move program appropriations by the lesser of five percent or \$100,000 without City Council approval, provided the total fund appropriation does not change. With the exception of project funds, appropriations revert to fund balance to the extent they have not been expended or encumbered at fiscal year end.

As required by the City charter, the annual budget (the Proposed Budget) is formulated by the Mayor and the Office of Management and Budget (OMB) and submitted to the City Council by April 1 for the fiscal year commencing July 1. City Council can amend the budget and votes to approve the budget at a meeting in May. The budget, as amended by the City Council is published as the Approved Budget.

A cleanup resolution may be performed in the middle of the fiscal year to make adjustments to anticipated revenues and expenditures. At the conclusion of each fiscal year the Mayor and City Council compare the budgeted versus actual revenues and expenditures. Any budget adjustments required are completed in a final "cleanup resolution" proposed by the Administration and amended and approved by City Council. OMB Management reports that cleanup bills will be proposed to City Council only when over-expenditures occur at the fund level.

General fund uses for FY03 were as follows:



Each year the City publishes the result of its revenues and expenditures in its Comprehensive Annual Financial Report (CAFR). The CAFR is audited by the City's external auditors and should be filed with the New Mexico State Auditor's Office by December 1. The FY03 CAFR had not been published at the completion of our fieldwork.

For a detail of FY03 budget vs. actual expenditures for all operating funds see attached tables A & B.

#### **SCOPE**

Our audit did not include an examination of all the functions, activities, and transactions of the June 30, 2003 Citywide close. Our audit test work was limited to the following areas:

- Compile a schedule of appropriations and actual expenditures identified by program, department and fund.
- Obtain explanations from the Administration regarding over-expenditures by the lesser of five percent or \$100,000 of the program appropriated amounts.
- Examine transfers all funds.
- Examine encumbrances all funds.
- Review changes in internal controls over expenditures as they relate to the City's budget.

The Office of Internal Audit conducted the audit of the FY03 year-end close in accordance with City Ordinance section 2-10-9 ROA 1994. This report and its conclusions are based on information taken from a sample of transactions and do not purport to represent an examination of all related transactions and activities. Our fieldwork was completed on December 15, 2003. The audit report is based on our examination of the City's activities through the completion of our fieldwork and does not reflect events or accounting entries after that date. The audit was conducted in accordance with Governmental Auditing Standards, except Standard 3.49, requiring an external quality control review.

#### **FINDINGS**

The following findings concern areas, which we believe would be improved by the implementation of the following recommendations.

# 1. <u>THE CAO SHOULD ENSURE THAT ALL PROGRAMS SPEND WITHIN APPROPRIATED BUDGETS</u>

The purpose of public budgeting is to provide government with a mechanism to allocate resources for the pursuit of goals that are consistent with community preferences and needs. The City budgets at the program level. Programs are contained within the City's different funds and are managed by departments. The program level in the Strategic Management framework is the level to which resources are appropriated in the City's

budget. Although the City is required by City ordinance and State statute to balance its budget at the fund level, the expenditures are appropriated at the program level. The City's Budget Ordinance, section 2-11-7 (B) ROA 1994 states, "A full-program budget will be prepared for all city departments each year. The program budget shall clearly identify each program that is proposed to be implemented or continued in the ensuing fiscal year and shall include the projected costs of each program." Established City policy requires each department to adhere to the budget at the program level. The fiscal year 2003 Proposed and Approved budgets state, "Appropriations are at a program strategy level, the level at which expenditures may not legally exceed appropriations." In addition, Administrative Instruction 2-20 states:

Program Strategies are the level at which appropriations are made. It is at this level that managers must ultimately be responsible for controlling expenditures.

All employees with budgetary control over a Program Strategy must accomplish their tasks within the approved budget. All personnel decisions and all expense decisions must be made within that framework. It is unacceptable for an employee with budgetary control to spend in excess of the appropriated budget.

Employees such as fiscal managers and human resource coordinators who may lack direct control, but serve in a direct advisory capacity for expenditure decisions, shall provide the best information available. If the manager fails to act in a financially prudent manner upon receipt of the advice, the fiscal manager and/or human resource coordinator shall report to the manager's supervisor. This process will be repeated at ascending levels of management until the financial advice is heeded. If necessary, after following this procedure, if he/she still believes corrections have not been made in line with the advice, he/she should report directly to the Chief Financial Officer. Failure to follow this procedure will result in the same disciplinary procedure applicable to the Program Strategy Manager, described below.

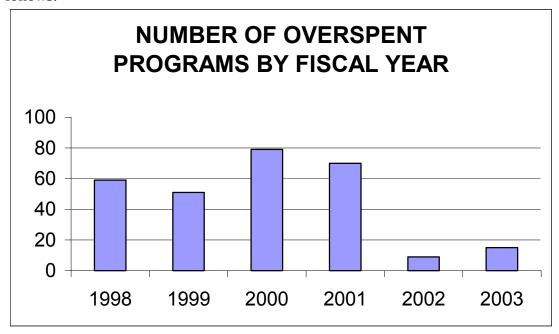
Failure on the part of the Program Strategy Manager to monitor and control expenses within the appropriated budget will be subject to disciplinary action as defined in the Personnel Rules and Regulations. Disciplinary action may include written reprimand, suspension, demotion, or dismissal.

The following programs had expenditures in excess of appropriations:

<b>Fund</b>	<b>Program</b>	<u>Ap</u>	<u>propriations</u>	<u>E</u> :	<u>xpenditures</u>		<b>Variance</b>
110	Early retirement	\$	4,000,000	\$	5,071,526	\$	(1,071,526)
110	Legislative coordinator	\$	185,000	\$	224,000	\$	(39,000)
110	Citywide finance supp <sup>2</sup>	\$	442,000	\$	485,866	\$	(43,866)
110	Police central cupport	\$	20,096,000	\$	20,624,052	\$	(528,052)
110	Sr aff. strategic supp <sup>2</sup>	\$	807,000	\$	811,733	\$	(4,733)
260	Corrections/Detention	\$	29,236,000	\$	35,587,845	\$	(6,351,845)
260	Community custody	\$	733,000	\$	855,976	\$	(122,976)
621	Jt water/sewer GF xfer <sup>2</sup>	\$	6,443,000	\$	6,455,401	\$	(12,401)
621	San Juan/Chama	\$	2,033,000	\$	2,273,463	\$	(240,463)
621	Low inc. utility credit <sup>2</sup>	\$	250,000	\$	253,525	\$	(3,525)
651	Refuse disposal GF xfer <sup>2</sup>	\$	2,677,000	\$	2,690,032	\$	(13,032)
691	Stadium fiscal agent <sup>1</sup>	\$	-	\$	22,625	\$	(22,625)
691	Xfer to debt service <sup>1</sup>	\$	-	\$	457,540	\$	(457,540)
705	Workers compensation <sup>1</sup>	\$	4,319,000	\$	5,346,921	\$	(1,027,921)
725	Fleet management <sup>1</sup>	\$	8,229,000	<u>\$</u>	8,432,561	\$	(203,561)
	Total	\$	79,450,000	<u>\$</u>	89,593,066	<u>\$</u>	(10,143,066)

- Final clean-up resolution approved by City Council and the Mayor increased appropriations in these programs subsequent to fiscal year end. The appropriations listed do not reflect that clean-up resolution.
- 2 Program was within 5% or \$100,000 and did not require an additional appropriation per City Ordinance.

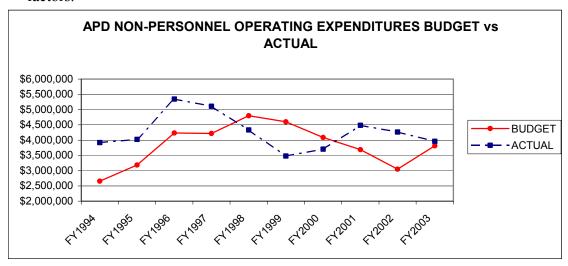
The number of overspent programs, as reported in the CAFR over the past five years is as follows:



As stated above, the Mayor has authority to move program appropriations by the lesser of five percent or \$100,000 without City Council approval, provided the fund appropriation does not change. The following explanations are provided for over-expenditures in excess of these amounts:

- Early retirement When the original budget is formulated it is difficult to determine which employees will retire and at what time. Employees wishing to retire typically do not make the information available at the time the budget is formulated. This program was projected to overspend throughout the year. The Administration did not seek an additional appropriation for this program during the year due to the inability to accurately predict total expenditures.
- Police central support Albuquerque Police Department (APD) management reports that this over-expenditure is primarily due to an aging vehicle fleet that required increased vehicle maintenance. However, based on an analysis of expenditure accounts within the program, vehicle maintenance expenditures account for only some of the over-expenditure. We also noted numerous discretionary expenditures that do not appear to be vital to the operation of this program. The Administration should ensure that APD operates within its appropriated budget.

As shown below, historical data also reveals that seven of the last ten years APD overspent its appropriation for non-personnel operating costs. Since these costs do not represent commitments for personnel expenditures, operating costs should be the most easily controlled. The Administration and APD management should determine if discrepancies between budget and actual expenditures are due to unrealistic budgeting, or inadequate control over expenditures, or a combination of the two factors.



• The Corrections and Detention Program and Community Custody programs overspent their appropriated budgets of \$29,236,000 and \$733,000 by \$6,352,845 and \$122,976, respectively. An examination of the programs' expenditures reveal that regular wages, overtime, professional and contractual services dramatically increased in FY2003 over FY2002.

When the FY2003 budget was approved, the Westside jail and the Bernalillo County Detention Center were to be closed and moved into the new Metropolitan Detention Center early in the fiscal year. However, Metropolitan Detention Center was not ready for full occupancy until June 5, 2003. As a result, the City incurred expenditures for three facilities instead of one. In addition, due to capacity limits, the City incurred expenditures to house inmates in other counties.

• The San Juan/Chama program overspent its appropriated budget of \$2,033,000 by \$240,000. Expenditures in this program include maintenance charges from the US Bureau of Reclamation, principal and interest payments for debt, and fees for water storage. Since expenditures from this program are contractual obligations, payments are mandatory. The Albuquerque Area Office of the Bureau of Reclamation received the maintenance charge estimates from their regional office in May 2002 but did not provide them to Public Works Department (PWD) management until October 2002. When the approved FY03 budget was formulated, PWD management did not have accurate maintenance charge projections from the US Bureau of Reclamation. In addition, it does not appear that expenditures for water storage were accurately budgeted.

During FY03, the US Bureau of Reclamation provided cost estimates that were higher than what was budgeted and budget projections throughout the year placed this program at risk for overspending. Neither PWD management nor the Administration sought an additional appropriation from City Council. PWD management does not have the authority to make any payments without an appropriation. If payments within a program are mandatory due to contractual obligations and adequate savings cannot be realized to ensure budget compliance, the Department responsible and the Administration should seek an additional appropriation **before** the program overspends. In addition, PWD management should develop a better method of communication with the Bureau of Reclamation to ensure more timely delivery of their cost estimates.

The San Juan/Chama program is in the City's Joint Water/Sewer Fund. At June 30, 2003 this fund had adequate fund balance and absorbed this over-expenditure. As a result, resources from other funds were not required.

• The Stadium fiscal agent, and Transfer to debt service programs were overspent \$22,625 and \$457,540 respectively. These programs were established during FY03 to

account for the operating and maintenance of the renovated baseball stadium for the local AAA baseball team. As a result, when the original budget was formulated, these programs were funded in the Sales Tax Refunding Debt Service Fund. In order to ensure proper accounting, these programs were moved into their own fund. Subsequent to June 30, 2003, the Administration submitted a clean up resolution to City Council to move the appropriation into the proper fund.

The Stadium fiscal agent and Transfer to debt service programs are located within the Sports Stadium Fund. Actual revenues exceeded budgeted revenues within this fund by \$289,230 or 67 percent. No additional resources were required from other funds.

- The Workers Compensation program was overspent by \$1,027,921. Existing laws regulating workers' compensation continue to make projecting claims difficult. The Workers Compensation program is in the City's Risk Management Fund. At June 30, 2003, this fund had a fund deficit of \$12,651,150 and could not absorb the over-expenditure. Subsequent to June 30, 2003, the Administration submitted a clean up resolution to City Council to adequately fund this program.
- The Fleet management program was overspent by \$203,561. The City's Fleet Manager reports that of the 2,892 vehicles owned at June 30, 2003, 1,080 or 37 percent are in need of replacement. In the fiscal year ended June 30, 1999, the Vehicle/Equipment Replacement Fund had unreserved/undesignated fund balance of \$4,551,745. Due to lack of funding in fiscal years 2000 thru 2003, the unreserved/undesignated fund balance has been reduced to \$788,141 at June 30, 2003. Since older vehicles are more expensive to maintain than newer ones, maintenance expenditures continue to rise.

The Fleet Manager reports that there are currently 139 vehicles on order and due to arrive in February of 2004. In addition, beginning July 1, 2004 the City will impose a ½ cent public safety tax. Also, voters approved general obligation bonds that may be used to purchase additional public safety equipment. Proceeds from the new tax are expected to be received starting in September 2004.

#### RECOMMENDATION

The CAO should ensure that all programs spend within the appropriated levels. For those programs that are overspent, the Administration should take appropriate action in accordance with Administrative Instruction No. 2-20.

For programs that are projected to overspend, but due to contractual obligations adequate savings cannot be realized, the department that is responsible for the program and the Administration should seek an additional appropriation from City Council before the program overspends.

#### EXECUTIVE RESPONSE FROM THE CAO

"The Administration appreciates the efforts of Internal Audit and believes these efforts have been valuable in keeping program expenditures within budgeted levels. However, one simple conclusion does not appear in this year-end report: in FY/2003, only one department overspent, causing only one fund to require a subsidy from the general fund to cover expenditures.

"According to the information presented in this report, the number of overspent programs has fallen from nearly 60 in FY/98 and nearly 80 in FY/00 to 15 in FY/03. Of the 15 (7.5% of approximately 200) City programs overspending, five were within 5% or \$100,000 and did not require any additional action or appropriation per City ordinance. Of the remaining 10 programs (5% of all programs), nine were corrected by appropriating available fund balances. The CAO believes that improved budget compliance is the result of pro-active management.

"The Office of the Chief Administrative Officer produces quarterly expenditure projections. These projections are reviewed with Department Directors at weekly Director's staff meetings and in quarterly meetings between the departments and the Office of Management and Budget (OMB). Both the Mayor and the Chief Administrative Officer have repeatedly warned department Directors that overspending will be met with severe consequences. Department staff and OMB staff work constructively to find ways to bring any projected program over-expenditures back to budgeted levels. approach has worked well. Unfortunately, Administrative Instruction 2-20 has not worked as well. The Chief Financial Officer did not receive any reports of overspending in Fiscal year 2003 from department fiscal staff in the manner called for in the AI. The CAO will consider repealing AI 2-20 in favor of a more constructive approach to managing potential over-expenditures.

"Although it is always proper to seek additional appropriation to cover over-expenditures, this solution is not always simple, economic, or feasible:

• Early projections are less accurate than projections prepared later in the fiscal year. It should be noted that if spending is equally distributed throughout the year, program overspending in excess of 8.33% does not occur until the last month of the

- fiscal year. It is not efficient to adjust program budgets based on questionable projections, only to adjust them later based on improved projections or actual spending.
- FY/03 presented unique challenges. Projected general fund revenue shortfalls resulted in dramatic reductions in appropriations early in the fiscal year. Because over-expenditures were projected, the Administration worked with departments to reduce spending. Until the final months of the fiscal year, it did not appear that additional appropriations could be supported.
- Spending projections for some programs contain an extraordinary degree of uncertainty. Efforts to better project early retirement needs by requesting employment history data from PERA have failed and employment rules do not allow the employer to inquire about retirement plans. At the same time, retirement claims must be honored.
- In Corrections programs, the Albuquerque Bernalillo County Governmental Commission must agree with the change in order to increase the appropriation level. Spending uncertainty was driven by repeated delays in moving into the Metropolitan Detention Center. Although projections indicating over spending were discussed, no motion to increase the appropriation level was offered because no "move in" date was known. The City is not the owner of the facility and the Administration was not responsible for construction. City staff did not have the information to accurately estimate the 'move in' date.
- The San Juan/Chama program receives updated cost estimates from the US Bureau of Reclamation in October, well after the City's budget has been approved. The City no longer manages the San Juan/Chama program. It was included in the transfer to the Albuquerque-Bernalillo Water Utility Authority. The budget for FY/05 will not be prepared by the Administration and will not be considered by the City Council.
- In the past, increasing appropriations at mid-year based on projected over spending sent the wrong signal to departments and actually discouraged budget compliance. If mangers believe the City will reward projected over expenditures by increasing appropriations, overspending is likely to increase.

<sup>&</sup>quot;The Administration's goal is for all programs to remain within budget."

# 2. <u>THE LEGAL DEPARTMENT SHOULD ENSURE THAT ALL REAL PROPERTY</u> TRANSACTIONS HAVE BEEN PROPERLY RECORDED

The Real Property Division (Real Property) of the Legal Department provides professional real property services to City departments. Real Property responsibilities include property purchases, sales, appraisals, environmental impact services, and maintaining real property inventory.

In FY2002, Real Property sold land that should have been recorded as revenue in the Transit Capital Grants fund and the Capital Acquisition fund. Instead, Real Property management erroneously recorded the revenue in the General Fund. This error was not detected until FY2003 when it was removed from the General Fund. This error resulted in an overstatement of General Fund revenue of \$360,784 in FY2002 and negative revenue in FY2003 causing the City's Comprehensive Annual Financial Reports in both fiscal years to be misstated.

The City's Real Property Manager states that the Surplus Agent position was deappropriated during the FY2002 reorganization. As a result, lease and real property transactions are not being tracked. However, when the Mayor and the Council approved the City's reorganization plan there were not to be cuts in service. Real Property Division management should have reallocated the responsibilities to ensure that all real property transactions were properly recorded.

#### RECOMMENDATION

The Legal Department should ensure that Real Property properly records all its transactions in the general ledger. Personnel in Real Property should be assigned to cover all responsibilities in the Division.

#### EXECUTIVE RESPONSE FROM LEGAL

"The Legal Department agrees. Processes and procedures now require that all deposits be processed through the fiscal officer to ensure correct coding to the general ledger. The real property manager has been diligent in seeing that all transactions within the Real Property Division are being recorded. Both individuals work together closely to correctly identify all transactions."

### 3. <u>CITY DEPARTMENTS SHOULD ENSURE THAT ENCUMBRANCE BALANCES</u> ARE PROPERLY STATED THROUGHOUT THE YEAR

The City utilizes an encumbrance system to help prevent over-expenditures. An encumbrance can be viewed as an expected expenditure. The advantage of using encumbrances is to recognize funds that have been committed for a specific expenditure before the corresponding liability has been incurred. This would allow a City department to add actual expenditures and encumbrances and compare the total to the department's appropriations. The department can then determine its budget status.

At June 30, 2003, the City's general ledger showed an encumbrance balance of \$4,860,218 for the General Fund. The Department of Finance and Administrative Services (DFAS) management made routine accrual and other adjustments of \$2,199,375. After further review by DFAS management, it was determined that \$2,644,463, or approximately 54 percent of the remaining encumbrances required additional corrections, leaving a final balance of \$16,380 of encumbrances in the General Fund.

Based on the data above, it appears that City departments are not maintaining an accurate encumbrance balance throughout the year. Although DFAS provides fiscal managers with monthly encumbrance reports, fiscal managers do not understand the need to maintain accurate encumbrance balances throughout the year. DFAS management does not have the authority over department fiscal managers to ensure that accurate encumbrance balances are maintained. The Encumbrance Administrative Instruction (Admin. Inst. No. 3-13) defines what encumbrances are, but does not provide any language requiring encumbrance balances to be accurate throughout the year. The purpose behind maintaining an accurate encumbrance balance is to assist in projecting expenditures before a liability is incurred. It is difficult to determine the total amount of commitments by the City at any given time if the encumbrance balances are not accurate.

#### RECOMMENDATION

The CAO should consider revising Administrative Instruction No. 3-13 to require encumbrance balances to be accurate throughout the year and establish consequences for failure to keep encumbrances accurate.

#### EXECUTIVE RESPONSE FROM THE CAO

"The CAO will consider revising Administrative Instruction No. 3-13. DFAS will continue to work with department fiscal staffs, and will issue encumbrance reports on a regular basis to focus attention on this issue."

# 4. <u>CITY DEPARTMENTS SHOULD ENSURE THAT ALL LIABILITIES ARE</u> PROPERLY RECORDED IN THE CORRECT FISCAL YEAR

#### A. Accounts Payable Liabilities Should Be Properly Accrued

The financial statements for the City are prepared in conformity with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standard Board (GASB). Those standards require the City to record expenditures as a liability in the City's general ledger when they are incurred, not when they are paid.

To ensure that expenditures were recorded in the correct fiscal year, we randomly selected a sample of 25 accounts payable checks from the 8,372 paid in July and August, 2003. The total value of the sample was \$62,117. We then examined the corresponding invoice and verified that if the liability was incurred during FY03, the corresponding expenditures were also appropriately recorded. We noted two disbursements totaling \$11,004, out of 25, which contained liabilities that should have been recorded in FY03 but were not recorded until FY04. An error discrepancy rate this high usually indicates that there are possible misstatements in expenditures and corresponding liabilities in the CAFR. An examination of the corresponding invoices for these disbursements reveals the following:

- Neither one of these disbursements had a correctly posted encumbrance. DFAS
  examines the encumbrance listing at the end of each year and accrues the
  applicable encumbrances. If the unaccrued transactions had been properly
  encumbered, it is likely that they would also have been properly accrued.
- In order to ensure budget compliance, some departments may be attempting to delay FY03 program expenditures until FY04.

#### B. City Departments Should Monitor Their Unmatched Invoice Listing

The City's internal control structure requires that invoices submitted to the City by a vendor must have a matching purchase order. If the invoice has a matching purchase order and the department has received the goods or services, payment is approved by the department through a release. If any of these items are missing, the invoice is placed in the City's unmatched invoice listing.

We examined the City unmatched invoice listing for June 30, 2003. The following is a schedule of departments that had unmatched invoices older than 180 days:

<b>Department</b>	# of invoices	<b>Amount</b>	
Convention Center	5	\$ 1,710	
Corrections	5	\$ 166,952	
DFAS	33	\$ 27,111	
Environmental Health	1 4	\$ 454	
Fire	1	\$ 573	
<b>Human Resources</b>	1	\$ 42	
Legal	13	\$ 2,132	
Mayor	15	\$ 3,361	
Parks & Recreation	4	\$ 547	
Police	57	\$ 28,336	
Public Works	60	\$ 96,778	
Solid Waste	9	\$ 15,104	
Transit	4	\$ 514	
Unassociated Depts.	15	\$ 1,160	
Total	226	\$ 344,744	

An examination of the unmatched invoice listing reveals current practices that may result in departures from GAAP. For example, two unmatched invoices at APD show computer equipment received in June of 2003 with a cost of \$19,515. On January 13, 2004 these invoices were still unmatched. APD Management reports that this equipment was received in June of 2003, but payment was not made due to purchase order adjustments. However, payment to the vendor for this equipment was made on January 15, 2004 for the same amount as listed on the original invoices. The costs were neither accrued, nor encumbered at year-end.

Department fiscal managers do not appear to be routinely clearing out the unmatched invoices. Administrative Instruction No. 3-7 states, "It is the policy of the City to pay all vendors in accordance with the terms of the contracts or within thirty days from the date of receipt of goods or services and/or date of invoice, whichever comes last." When the invoices on the unmatched invoice listing are allowed to age longer than thirty days:

- City departments may not be in compliance with Administrative Instruction 3-7.
- Delays in paying vendors may result in interruption of goods and services.
- The City may not be recording liabilities and expenditures in accordance with GAAP causing misstatements in the City's CAFR.

#### RECOMMENDATION

City departments should ensure that all liabilities are properly recorded in the correct fiscal year. An examination should be performed on all funds to determine the total amount of unrecorded liabilities and the City's CAFR should be restated accordingly.

The CAO should consider revising Administrative Instruction No. 3-7 to include consequences for failure to monitor unmatched invoices. All departments should monitor the unmatched invoice listing and routinely research and resolve unmatched invoices that age more than 30 days.

### EXECUTIVE RESPONSE FROM THE CAO

"The CAO will consider revising Administrative Instruction No. 3-7. DFAS will continue to work with departmental fiscal staffs, and will issue unmatched invoice reports on a regular basis to focus attention on this issue.

"The Administration believes that the issue of unmatched invoices has an impact on whether liabilities are recorded in the correct fiscal year. Additional efforts will be made in connection with the preparation of the FY/2004 CAFR to ensure that liabilities are recorded in the correct fiscal year."

# 5. <u>THE CAO SHOULD RE-EVALUATE CITY POLICY ON THE PURCHASE OF PERSONAL-USE ITEMS FOR USE BY EMPLOYEES</u>

Administrative Instruction No. 3-11 Purchase of Personal-Use Items For Use By Employees states:

It is the City's policy that City funds will not be used to purchase gifts, amenities, or items for the personal use of employees or for consumption by employees, unless the items are required to perform assigned department responsibilities or functions.

Purchases of personal-use items or consumable items include, but are not limited to, foodstuffs, coffee and related supplies, coffeepots, microwave ovens, and television sets. The City will not pay for meals or other supplies for award ceremonies or for retirement dinners or parties. However, the purchase of a plaque or trophy for a CAO-approved awards program would be an appropriate expenditure of City monies.

An examination of City expenditures reveals that the Transit Department (Transit) has purchased Nambe ware for retiring employees. Transit has a CAO approved awards program that allows these expenditures. However, the Family and Community Services Department (FCSD) also purchased similar items for their retiring employees, but FCSD does not have a CAO approved awards program.

It appears that some departments may be confused as to what awards/retirement purchases are allowable and with what dollar amounts. In addition, FCSD management reports that they were unaware of the Administrative Instruction and have been purchasing these types of gifts for retirements for some time.

The following issues concern the purchase of gifts such as these:

- Legal Department personnel have expressed concern that the purchase of these gifts/awards may not be in accordance with the State Constitution. The Administration should obtain a legal opinion to ensure that these types of purchases are in accordance with the State Constitution.
- The Administrative Instruction is not uniformly being applied to all City Departments and employees. The Administration should establish a policy that uniformly covers all departments and sets a dollar limit on gifts and awards, if allowable. Some departments do not purchase retirement gifts with City funds, while others have spent in excess of \$200 per employee for retirement gifts.
- FCSD purchased some of their awards with funds provided by a Federal Grant. OMB Circular A-87, Cost Principles for State, Local and Indian Tribal Governments requires expenditures be authorized or not prohibited under State or local laws or regulations. Since FCSD does not have a CAO approved awards program and these purchases may not be in accordance with the State Constitution, FCSD management may not be in compliance with OMB Circular A-87.

#### RECOMMENDATION

The CAO should review Administrative Instruction No. 3-11 to ensure that the policy is in compliance with the State Constitution, uniformly covers all City departments, and prohibits retirement/award purchases from grants.

### EXECUTIVE RESPONSE FROM THE CAO

"The CAO has been considering modifying Administrative Instruction No. 3-11 to bring it into line with current IRS rules and regulations

regarding the provision of de minimus benefits to employees, and making it applicable to all departments city-wide. The revised Administrative Instruction would be effective no later than the close of this fiscal year."

### 6. <u>THE HOUSING DIVISION SHOULD PAY INDIRECT OVERHEAD AS REQUIRED</u> BY ADMINISTRATIVE INSTRUCTION NO. 2-1

The Albuquerque Public Housing Authority (APHA) is a division of the Family and Community Services Department and owns and manages approximately 950 units of housing that are made available to low income families, disabled people and the elderly. In addition, APHA provides rental assistance to qualified low-income families to purchase housing in the private rental market. Most of APHA's revenues are grants from the US Department of Housing and Urban Development (HUD).

Before public housing can be developed in a community, the entity must enter into a cooperative agreement with the local governing body. Under the cooperative agreement, the locality provides services such fire and police protection. Citizens and business located within the City pay taxes in order to receive services from the City. APHA may also be required make a Payment in Lieu of Taxes (PILOT) for these services.

Indirect overhead is also a charge assessed against many of the City's enterprise funds and special revenue funds to recover General Fund costs that benefit the other funds. Administrative Instruction No. 2-1 states, "It is the City's policy to recover General Fund costs incurred in providing services to departments and agencies which are not financed by the General Fund. Therefore, indirect costs will be assessed against all applicable activities in accordance with the City's approved Central Services Cost Allocation Plan." It is the City's policy to charge indirect costs for all grants proposals, setting rates for utilities, and establishing capital project budgets.

OMB Circular A-87, Cost Principles Applicable to Grants and Contracts with State and Local Government Agencies and HUD regional office personnel state that in order to charge indirect overhead to a housing authority funded by HUD, the locality must have a Central Service Cost Allocation Plan approved by the locality's Cognizant agency. The City's plan is prepared pursuant to principles and guidelines outlined in OMB Circular A-87 and has been approved by the City's Cognizant agency.

In FY2001, APHA paid \$170,000 in PILOT payments to the City. Based on current estimates, APHA should have paid this same amount in FY03. In FY01 and in prior years the City did not record the revenue received from APHA as PILOT revenue, but as Indirect Overhead. APHA management determined that this was an inappropriate way to account for this revenue and discontinued payments. However, the City continues to provide services such as police and fire as well as indirect services identified in the City's

Central Service Cost Allocation Plan. It appears that APHA is receiving services without payment. Both PILOT and Indirect Overhead are allowable expenditures under HUD guidelines and should be assessed to APHA by the City.

#### RECOMMENDATION

The City should assess indirect overhead charges in accordance with its approved Central Service Cost Allocation Plan and Administrative Instruction No. 2-1. In addition, PILOT charges should also be assessed.

The CAO should implement an Administrative Instruction that defines what PILOT is, and under what circumstances PILOT will be assessed.

#### EXECUTIVE RESPONSE FROM THE CAO

"The Administration concurs and will assess indirect overhead charges in accordance with the approved Central Cost Allocation Plan. Unfortunately, it may not be possible to recover the indirect charges for the current fiscal year. If the overhead is appropriated in the FY/2005 budget, we believe HUD will accept the cost. A draft Administrative Instruction on PILOT has been discussed with the Internal Audit staff and is currently under review."

#### CONCLUSION

By implementing the above recommendations, the City can further improve its administration and control over the budget process.

We appreciate the cooperation of City staff during the audit.

Budget Auditor	
REVIEWED and APPROVED:	APPROVED FOR PUBLICATION:
Debra D. Yoshimura, CPA, CIA, CGAP Internal Audit Officer	Chairman, Audit Committee